

UNITED STATES DISTRICT COURT
DISTRICT OF NEVADA

PATRICK WEST,) 3:05-CV-0394-ECR-RAM
)
)
Plaintiff,) ORDER
)
vs.)
)
INNOTRAC CORPORATION, a)
Georgia Corporation,)
and DOES I through X,)
inclusive,)
)
)
Defendants.)
_____)

I. Procedural Background

On August 15, 2005, Patrick West ("West" or "Plaintiff") filed an Amended Complaint against Innotrac and ten other unnamed defendants ("Innotrac" or "Defendants") alleging claims of breach of contract, breach of implied covenant of good faith and fair dealing, fraud or intentional misrepresentation, negligent misrepresentation, breach of duty of care, intentional omissions and failure to disclose, general negligence, breach of fiduciary duty, and violations of Section 12(a)(2) of the Securities Act of 1933 and Rule 10b-5 of the Securities Exchange Act of 1934, violation of NRS 90.570, 90.580, and 90.605 and violation of

1 Nevada's RICO statute. On August 29, 2005, Defendants filed a
2 Motion to Dismiss (#14). Plaintiff responded to the Motion (#18)
3 on September 21, 2005, and Defendants replied (#19) on October 5,
4 2005. The motion (#14) is ripe, and we now rule on it.

5 For the reasons stated below, Defendants' motion (#14) will
6 be **granted in part and denied in part.**

7 8 **II. Statement of Facts**

9 In considering motions to dismiss, we take the evidence as
10 presented in Plaintiff's Complaint in the light most favorable to
11 the Plaintiff.

12 Patrick West was an owner of UDS when he and the other owners
13 and shareholders were approached by Innotrac in December 2000 to
14 merge the two companies. On December 8, 2000, Innotrac and UDS
15 and shareholders of UDS entered into a Merger Agreement in which
16 Innotrac was to purchase UDS and give shares of Innotrac to the
17 shareholders of UDS. West was given shares upon the merger and
18 became a shareholder of Innotrac in January 2001. He remained a
19 shareholder until January 2004. Pursuant to the Merger Agreement,
20 West also became an employee of Innotrac. West was employed by
21 Innotrac from January 2001 until March 2004. West signed an
22 Employment Agreement (Exhibit A attached to the Amended
23 Complaint). which provided that West would receive exercisable
24 options to purchase 50,000 shares of common stock of Innotrac at a
25 price equal to the fair market value of the shares valued at the
26 date of the granting of the options. Such purchase was subject to
27 terms and conditions as set forth in a separate option agreement
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1 and in the "stock option plan." Such terms and conditions
2 included that 50% of the options would vest on the second
3 anniversary of the date the options were granted, 25% on the third
4 anniversary, and 25% on the fourth anniversary. This grant was
5 conditioned, however, on West remaining an employee of Innotrac.
6 West claims that although he was given a copy of the Employment
7 Agreement, he was never given a copy of the stock option plan or a
8 separate option agreement even though his signature appears on the
9 separate option agreement. West claims he was not informed, orally
10 or in writing, as to the expiration of the stock options upon his
11 resignation.

12 In February 2001, Innotrac authorized the issuance of stock
13 options in West's name for 50,000 shares. At the time the options
14 were issued, the fair market value of each share (the strike
15 price) was \$3.125.

16 On December 5, 2003, West communicated his desire to exercise
17 his stock options beginning in January 2004 with the intent being
18 to sell all his shares in Innotrac at the end of January 2004.¹
19 In a meeting with Innotrac executives on December 15, 2003, he
20 again communicated his desire to exercise his stock options.
21 Innotrac's President Scott Dorfman and David Farnsey rejected
22 West's exercise of his stock options claiming that West had
23 entered into an agreement with IPOF, an investment fund, that he,
24 as an Innotrac executive, would not dispose of Innotrac shares.

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26 ¹In January 2004, Innotrac shares were trading at \$11.00 per
27 share. West would have been entitled in January 2004 to 37,500 shares
28 which would have vested by that time.

1 West was informed that if he intended to sell his shares, that he
2 would need to include his shares in a private placement sale for
3 Innotrac executives.

4 West claims that on March 1, 2004, other officers and
5 executives sold shares of Innotrac causing a loss of \$10,000,000.
6 West resigned from Innotrac on March 29, 2004, before the loss was
7 publicly announced.

8 On January 10, 2005, nine months after his resignation, West
9 again attempted to exercise his stock options. His request was
10 again refused by Dorfman who claimed that stock options needed to
11 be exercised within 90 days of an employee's resignation. West
12 claims that the 2000 Stock Option and Incentive Award Plan which
13 was effective March 28, 2000, before Innotrac gained control of
14 UDS, did not contain a ninety-day expiration period but allowed up
15 to ten years after issuance of the options for exercise.

16 Plaintiff claims that although there is a stock option
17 agreement which has Plaintiff's signature on it, the signature is
18 a forgery and that he never saw such document, let alone signed
19 it.

20 21 **III. Discussion**

22 Innotrac has moved to dismiss Plaintiff's Tort Claims - Third
23 (Fraud), Fourth (Negligent Misrepresentation), Fifth (Breach of
24 Duty of Care), Sixth (Intentional Omissions and Failure to
25 Disclose), and Eighth (General Negligence) as barred by the
26 doctrine of economic loss. Innotrac has also moved to dismiss
27 Plaintiff's Seventh Claim for Relief (Breach of Fiduciary Duty)

1 because Nevada law does not recognize a fiduciary duty between a
2 corporation and its shareholders or between an employer and its
3 employees. Innotrac also moves for dismissal of Plaintiff's Ninth
4 (Federal Securities) and Eleventh (Nevada Securities) Claims for
5 Relief because Plaintiff did not pay anything for the options and
6 therefore has no damages. Innotrac moves for dismissal of
7 Plaintiff's Tenth Claim of Relief (Federal Securities Fraud)
8 because Plaintiff has failed to plead with particularity as is
9 required under Rule 9(b) and the Private Securities Litigation
10 Reform Act of 1995. Innotrac also moves to dismiss Plaintiff's
11 Twelfth Claim for Relief (Nevada RICO) as Plaintiff has failed to
12 plead all the elements of such a violation. And lastly,
13 Defendants have moved to dismiss Plaintiff's Thirteenth Claim for
14 Relief (Punitive Damages) because, if the tort claims are
15 dismissed, Plaintiff has no right to punitive damages under his
16 remaining claims.

17 **A. Standard of Review**

18 A motion to dismiss under Fed. R. Civ. P. 12(b)(6) will only
19 be granted if "it appears beyond doubt that plaintiff can prove no
20 set of facts in support of his claim which would entitle him to
21 relief." Lewis v. Tel. Employees Credit Union, 87 F.3d 1537, 1545
22 (9th Cir. 1996). On a motion to dismiss, "we presum[e] that
23 general allegations embrace those specific facts that are
24 necessary to support the claim." Lujan v. Defenders of Wildlife,
25 504 U.S. 555, 561 (1992) (quoting Lujan v. Nat'l Wildlife Fed'n,
26 497 U.S. 871, 889 (1990)) (alteration in original). Moreover,
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1 "[a]ll allegations of material fact in the complaint are taken as
2 true and construed in the light most favorable to the non-moving
3 party." In re Stac Elecs. Sec. Litig., 89 F.3d 1399, 1403 (9th
4 Cir. 1996) (citation omitted).

5 Although courts generally assume the facts alleged are true,
6 courts do not "assume the truth of legal conclusions merely
7 because they are cast in the form of factual allegations." W.
8 Mining Council v. Watt, 643 F.2d 618, 624 (9th Cir. 1981).
9 Accordingly, "[c]onclusory allegations and unwarranted inferences
10 are insufficient to defeat a motion to dismiss." In re Stac
11 Elecs., 89 F.3d at 1403 (citation omitted).

12 Review on a motion pursuant to Fed. R. Civ. P. 12(b)(6) is
13 normally limited to the complaint itself. See Lee v. City of Los
14 Angeles, 250 F.3d 668, 688 (9th Cir. 2001). If the district court
15 relies on materials outside the pleadings in making its ruling, it
16 must treat the motion to dismiss as one for summary judgment and
17 give the non-moving party an opportunity to respond. Fed. R. Civ.
18 P. 12(b); see United States v. Ritchie, 342 F.3d 903, 907 (9th
19 Cir. 2003). "A court may, however, consider certain materials --
20 documents attached to the complaint, documents incorporated by
21 reference in the complaint, or matters of judicial notice --
22 without converting the motion to dismiss into a motion for summary
23 judgment." Ritchie, 342 F.3d at 908.

24 If documents are physically attached to the complaint, then a
25 court may consider them if their "authenticity is not contested"
26 and "the plaintiff's complaint necessarily relies on them." Lee,
27 250 F.3d at 688 (citation, internal quotations and ellipsis
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omitted). A court may also treat certain documents as incorporated by reference into the plaintiff's complaint if the complaint "refers extensively to the document or the document forms the basis of the plaintiff's claim." Ritchie, 342 F.3d at 908. Finally, if adjudicative facts or matters of public record meet the requirements of Fed. R. Evid. 201, a court may judicially notice them in deciding a motion to dismiss. Id. at 909; see Fed. R. Evid. 201(b) ("A judicially noticed fact must be one not subject to reasonable dispute in that it is either (1) generally known within the territorial jurisdiction of the trial court or (2) capable of accurate and ready determination by resort to sources whose accuracy cannot reasonably be questioned.").

"Dismissal on statute of limitations grounds can be granted pursuant to Fed. R. Civ. P. 12(b)(6) 'only if the assertions of the complaint, read with the required liberality, would not permit the plaintiff to prove that the statute was tolled.'" TwoRivers v. Lewis, 174 F.3d 987, 991 (9th Cir. 1999) (quoting Vaughan v. Grijalva, 927 F.2d 476, 478 (9th Cir. 1991) (internal citations omitted)).

As Plaintiff attached to his Complaint the Employment Agreement as Exhibit A, we will consider it in determining the Motion to Dismiss.

B. Economic Loss Doctrine

In Nevada, "under the economic loss doctrine, economic losses are not recoverable in negligence absent personal injury or damages to property other than the defective entity itself."

1 Calloway v. City of Reno, 116 Nev. 250, 993 P.2d 1259 (2000)
2 (superseded by statute on the grounds that "a negligence claim can
3 be alleged in a construction defects cause of action initiated
4 under Chapter 40.") (Olson v. Richard, 89 P.3d 31, 33 (2004)). "The
5 economic loss doctrine marks the fundamental boundary between
6 contract law, which is designed to enforce the expectancy
7 interests of the parties, and tort law, which imposes a duty of
8 reasonable care and thereby encourages citizens to avoid causing
9 physical harm to others." Calloway, 116 Nev. at 256. "The
10 question to be determined . . . is whether the actions or
11 omissions complained of constitute a violation of duties imposed
12 by law, or of duties arising by virtue of express agreement
13 between parties." Id.

14 Plaintiff claims that the economic loss doctrine should not
15 apply to West's claims because, as in Olson, the Nevada state
16 legislature intended there to be negligence actions for tort
17 damages caused in connection with the sale of securities.
18 Plaintiff cites NRS 90.570 and 90.660 for such a proposition.

19 However, Plaintiff's argument is inapposite. In Olson, the
20 Nevada Supreme Court held that NRS 40.640 expanded but did not
21 *expressly define* the liability for construction defects.
22 Therefore, NRS 40.640 allowed homeowner's recovery under common
23 law *not statute* for tort as well as contract and warranty as the
24 legislature had expanded recovery to reach tort damages.

25 However, with regard to NRS 90.570 and 90.660, the Nevada
26 legislature has *specifically* limited the liability and has not
27 broadened the tort recovery under common law. Indeed, the passage
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1 from NRS 90.660 cited by Plaintiff in his opposition expressly
2 holds that "the purchaser may recover the consideration paid for
3 the security and interest at the legal rate of this state from the
4 date of payment, costs and reasonable attorney's fees, less the
5 amount of income received on the security." NRS 90.660. As this
6 section demonstrates, if the plaintiff can demonstrate violation
7 of either NRS 90.310, NRS 90.500, NRS 90.570, NRS 90.610 or NRS
8 90.500, the plaintiff can recover *specific statutory damages*. The
9 Nevada legislature's intent in creating this provision was not to
10 expand the tort damages that could be recovered beyond those for
11 breach of contract, but it was to give plaintiffs additional
12 statutory recovery. We do not dispute Plaintiff's ability to sue
13 under NRS 90.660 for statutory damages but we reject his attempt
14 to broaden this statute to allow tort recovery normally barred by
15 the economic loss doctrine.

16 Plaintiff is unable to cite to a case holding that the
17 relationship between a shareholder and an officer or an employer
18 and employee creates an exception to the doctrine of economic
19 loss.

20 Plaintiff cites Western Industries, Inc. v. General Insurance
21 Co., 91 Nev. 222, 533 P.2d 473 (1975) for the proposition that
22 corporate directors have a fiduciary relationship to their
23 shareholders. We reject this contention finding it a disingenuous
24 characterization of the case - Western stands for the proposition
25 that a corporate director has a duty of good faith, honesty and
26 disclosure to *the corporation* as opposed to the shareholders.
27 Western, 533 P.2d at 476.

1 Although Plaintiff claims that Leavitt v. Leisure Sports,
2 Inc., 103 Nev. 81, 734 P.2d 1221 (1987) stands for the proposition
3 that a corporate officer has a fiduciary duty to its shareholders,
4 we find this characterization, again, disingenuous. Leavitt
5 quotes Western for the proposition that "a corporate officer or
6 director stands as fiduciary to the corporation." Leavitt, 103
7 Nev. at 86 (quoting Western, 533 P.2d at 476).

8 Judge Pro reached the same conclusion in Agribiotech, Inc. v.
9 Anthony H.N. Schnelling, 319 B.R. 216, 223 (D. Nev. 2004) quoting
10 *the exact same language* we have cited above from the Nevada
11 Supreme Court indicating there is nothing concrete said concerning
12 the fiduciary relationship between corporate officers and its
13 shareholders. Although shareholders can sue in class action on
14 behalf of the corporation for a duty owed to the corporation, id.
15 at 223, this case says nothing about a fiduciary relationship owed
16 to shareholders.

17 The above analysis of the cases Plaintiff puts forth, we
18 find, characterizes the rest of the cases and treatises that
19 Plaintiff cites. In addition, we do not see how such a fiduciary
20 duty of corporate officers to shareholders, if it existed, would
21 create an exception to the doctrine of economic loss and would
22 allow for recovery of tort damages for claims based on contractual
23 duties. In addition, Plaintiff has failed to show how the breach
24 of the Merger Agreement and Employment Agreement would have
25 affected his status as a shareholder. Plaintiff is alleging
26 claims that he, as an employee, was given stock options which were
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1 not granted under contract. None of these claims relate to his
2 position as a shareholder.

3 Plaintiff's cite to Bernard v. Rockhill Development, 103 Nev.
4 132, 734 P.2d 1238 (1987) does not support his contentions. In
5 Bernard, the Nevada Supreme Court held that because Bernard's
6 claims were *not based on the contract*, Bernard could recover for
7 tort damages separate from damages based on the contract.

8 Plaintiff lastly claims that the Nevada Supreme Court has
9 held that "a plaintiff can assert a contractual claim and also one
10 for fraud based on the facts surrounding the contract's execution
11 and performance." Great American Ins. Co. v. General Builders,
12 Inc., 113 Nev. 346, 351, 934 P.2d 257 (1997). Plaintiff overlooks
13 the fact that the basis for this holding in Great American Ins.
14 related to a breach of implied covenant of good faith and fair
15 dealing - a claim which Defendants have not moved to dismiss in
16 this case. We do not address Plaintiff's ability to bring such a
17 claim and focus only on those tort claims outside the First and
18 Second Claims for Relief.

19 We therefore examine West's claims to determine whether they
20 allege damages in connection with the breach of the agreements
21 between West and Innotrac (Employment Agreement and Merger
22 Agreement) or whether they allege damages in connection with a
23 tort liability separate from the liability under contract.

24 West's Third Claim for Relief is for fraud in connection with
25 statements made to West when he attempted to exercise his options
26 in December 2003. West claims that such false representations
27 were intentionally made to induce West into not exercising his
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1 options. He also claims that the forged signature constitutes
2 fraud. However, these false representations and the alleged
3 forgery are part of the breach of contract claim. In making these
4 false statements, it is alleged that Innotrac breached its
5 agreement to provide West with those stock options. Whether or
6 not the signature is genuine will be a question of fact in the
7 contract action. This Court has held that "the Nevada Supreme
8 Court would find that the economic loss doctrine bars intentional
9 fraudulent tort claims that are interwoven with contractual
10 claims." Yerington Ford, Inc. v. GMAC, 359 F.Supp.2d. 1075, 1082
11 (D. Nev. 2004). Therefore, West's Third Claim for Relief is
12 barred by the economic loss doctrine.

13 West's Fourth Claim for Relief based on negligent
14 misrepresentations is similar to the fraudulent misrepresentations
15 alleged in Third Claim for Relief. See id. at 1094.

16 West's Fifth Claim, regarding a duty to disclose accurate
17 information, is based on the "employer contract" and is therefore
18 barred by the economic loss doctrine.

19 West's Eighth Claim of Relief is also based on insufficient
20 information which caused him not to be able to exercise his stock
21 options. Thus, this claim, based on the contract at issue, is
22 barred as well.

23 24 **C. Breach of Fiduciary Duty**

25 As has been discussed above, Plaintiff has been unable to
26 find caselaw in Nevada for the proposition that, *as specified in*
27 *common law*, a corporate officer has a fiduciary duty to the
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1 shareholders. Because Plaintiff cannot create a basis of
2 liability, his Eighth Claim of Relief, for breach of fiduciary
3 duty, will be dismissed.

4 We note, in addition, that Plaintiff is suing for his
5 inability, as an employee under contract, to exercise his stock
6 options and not as to any claim that relates to loss of value of
7 his stocks which affected his status as a shareholder. Therefore,
8 this "breach of fiduciary duty" based on his status as a
9 shareholder will also be dismissed on this ground.

10 Plaintiff also argues that there is a fiduciary duty between
11 an employer and an employee.² Plaintiff's cases are inapposite to
12 these propositions: (1) White Cap. Indus., Inc. v. Ruppert, 119
13 Nev. 126, 67 P.3d 318, 319 (2003) stands for the proposition that
14 an employee has a *duty of loyalty* to the corporation; (2) Matthews
15 v. Collman, 110 Nev. 940, 942, 878 P.2d 971 (1994) also stands for
16 the proposition that an employee has a duty of loyalty to her
17 employer; (3) Jory v. Bennight, 91 Nev. 763, 542 P.2d 1400 (1975)
18 allowed homeowners to sue for breach of fiduciary duties against a
19 real estate broker; and (4) Southwest Gas. Corp. v. Ahmad, 99 Nev.
20 594, 668 P.2d 261 (1983) held that employee handbook provisions
21 created express duties between an employer and an employee.
22 Nothing in these cases demonstrates that a fiduciary duty exists
23 between an employee and an employer.

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25 ²Although the Nevada Supreme Court has held that a special
26 reliance exists between the two parties (employer and employee) in
27 limited contexts that would justify tortious breach of implied
28 covenant of good faith and fair dealing, it has not found such special
relationship sufficient to create a fiduciary duty. Martin v. Sears,
Roebuck & Co., 111 Nev. 923, 926-27, 899 P.2d 551 (1995).

1 We note that the Ninth Circuit has held that "fiduciary
2 duties in the employer-employee relationship are limited to
3 discrete, well-defined obligations." Thorman v. Am. Seafoods Co.,
4 421 F.3d 1090, 1098 (9th Cir. 2005) (citing 19 Richard A. Lord,
5 *Williston on Contracts* §54.18 (4th ed. 2003) ("explaining
6 employers owe employees 'two basic duties': (1) compensation in
7 accordance with their agreements and indemnification for losses
8 and (2) a safe workplace.")). For example, an employer is subject
9 to fiduciary duties imposed by federal law. Id. Accordingly,
10 while state and federal statutory law can create a fiduciary
11 relationship between an employer and employee, Nevada common law
12 imposes no such obligations between these parties.

13 We find, therefore, that there was no basis for a claim of
14 fiduciary duty between Plaintiff and Defendants and therefore
15 there could be no breach of this fiduciary duty.

16 **D. Securities Claims**

17 Defendants claim that Plaintiff's securities claims (state
18 and federal) should be dismissed as Plaintiff did not pay anything
19 for his stock options and therefore has no damages and no relief
20 sought.
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22 Defendants argue that since damages in a Section 12(a)(2)
23 action are limited to "rescission" or "rescission-like" damages,
24 Plaintiff has not suffered damages and cannot recover anything
25 since he never paid for the options. 15 U.S.C. §771(2)(a).

26 Defendants' argument is a misstatement of this Circuit's
27 interpretation of securities law. The Ninth Circuit has held that
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1 a grant of employee stock options (as opposed to a stock bonus for
2 employees) is a "sale" for purposes of Section 12(a)(2) and
3 therefore can support a claim under the securities act. Falkowski
4 v. Imation Corp., 309 F.3d 1123 (9th Cir. 2002). "The grant of an
5 employee stock option on a covered security is therefore a 'sale'
6 of that covered security. The option is a contractual duty to
7 sell a security at a later date for a sum of money, should the
8 employee choose to buy it. Whether or not the employee ever
9 exercises the option, it is a 'sale' under Congress' definition."
10 Falkowski, 309 F.3d at 1129-30.

11 Because the Ninth Circuit has held that a grant of a stock
12 option plan is a sufficient basis for a "sale" under Section
13 12(a)(2), we find that Plaintiff has a sufficient basis for his
14 Ninth Claim of Relief and Defendants' motion to dismiss will be
15 denied.

16 The exact amount of Plaintiff's damages will be determined at
17 a later time. We refuse to look now into our crystal ball to
18 determine damages before liability. We note that the exercise of
19 the stock options was conditioned on Plaintiff's continued
20 employment with Innotrac making the ability to exercise those
21 options seemingly dependent upon Plaintiff's contribution of labor
22 to the corporation. Since this may be construed as the basis for
23 the damages, we find that the motion to dismiss on this claim is
24 without merit.

25 We find the same reasoning persuasive in declining to dismiss
26 the Nevada state securities action. First, the granting of
27 employee stock options can be seen as a "sale" of securities for
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1 purposes of NRS 90.570. Second, Plaintiff may be awarded damages
2 on the basis that he devoted labor or that he gained these options
3 in exchange for labor and therefore, the claim that there are no
4 damages is without merit.

5
6 **E. Failure to Plead with Particularity**

7 Defendants' claims that Plaintiff has failed to plead his
8 Tenth Claim for Relief, for violation of the Securities Act 10b-5,
9 17 C.F.R. § 240.10b-5, with particularity required by Fed. R. Civ.
10 P. 9(b) and by the Private Securities Litigation Reform Act of
11 1995 ("PSLRA"), 15 U.S.C. § 78u-4(b) (1).

12 The elements that Plaintiff must plead in a 10b-5 violation
13 are (1) a misstatement or false statement, (2) of material fact,
14 (3) scienter, (4) causation, (5) damages. DSAM Global Value Fund
15 v. Altris Software, Inc., 288 F.3d 385, 388 (9th Cir. 2002).

16 Under the Private Securities Litigation Reform Act, § 78u-
17 4(b) (1-2), a complaint must "specify each statement alleged to
18 have been misleading, the reason or reasons why the statement is
19 misleading, and, if an allegation regarding the statement or
20 omission is made on information and belief, the complaint shall
21 state with particularity all facts on which the belief is formed."
22 15 U.S.C. § 78u-4(b) (1). In addition, the complaint is required
23 to "state with particularity facts giving rise to a strong
24 inference that the defendant acted with the required state of
25 mind." 15 U.S.C. § 78u-4(b) (2). The required state of mind
26 defined by the Ninth Circuit is acting with "intentionality or
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1 deliberate recklessness . . .” Ronconi v. Larkin, 253 F.3d 423,
2 429 (9th Cir. 2001) (internal quotations and citations omitted).

3 In order to meet the requirements of Fed. R. Civ. P. 9(b), a
4 complaint must plead the “circumstances constituting fraud.” In
5 re GlenFed, Inc. Sec. Litig., 42 F.3d 1541, 1548 (9th Cir. 1994).
6 The circumstances including the “time, place, and nature of the
7 alleged fraudulent activities,” must be plead as well as why those
8 statements were false. Walling v. Beverly Enterprises, 476 F.2d
9 393, 397 (9th Cir. 1973); Warshaw v. Xoma Corporation, 74 F.3d
10 955, 957 (9th Cir. 1996).

11 First, regarding the requirements of Fed. R. Civ. P. 9(b),
12 Plaintiff has plead sufficiently. West has included the content
13 of allegedly false statements made to him at the time he attempted
14 to exercise his options in December 2003 and in January 2005, nine
15 months after his resignation. Plaintiff has included a reason for
16 their falsity – that Defendants had no relationship with IPOF that
17 he was aware of and although Defendants claimed he had signed an
18 agreement that would limit the exercising of his options to 90
19 days after leaving Innotrac, Plaintiff claims he never saw such
20 document, let alone signed it.

21 Turning then to the requirements of the PSLRA, Plaintiff has
22 again plead the misstatements and alleged why they were false. In
23 addition, Plaintiff has plead the scienter element by displaying
24 Defendants’ intent in denying him the ability to exercise his
25 stock options. Plaintiff claims that “[i]f West was denied his
26 ability to exercise his stock options, Innotrac would have fewer
27 issued shares, the share price would remain higher, the Innotrac
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1 shares would avoid dilution, and the optioned shares would return
2 to the pool of shares available to be issued to the officers and
3 employees of Innotrac under securities regulations." We find that
4 West has therefore sufficiently plead his section 10b-5 securities
5 claim.

6
7 **F. RICO Claims**

8 Plaintiff has also plead a RICO claim based on Defendants'
9 violation of Nevada state securities laws NRS 90.570, 90.580, and
10 90.660.

11 The racketeering statute of Nevada makes it unlawful for a
12 person:

13 (A) Who has with criminal intent received any
14 proceeds derived, directly or indirectly, from
15 racketeering activity to use or invest, whether
16 directly or indirectly, any part of the proceeds, or
17 the proceeds derived from the investment or use
18 thereof, in the acquisition of:

16 (1) Any title to or any right, interest or equity
17 in real property; or

17 (2) any interest in or the establishment or
18 operation of any enterprise...

18 NRS 207.400.

19 As can be discerned from the statute, there must be a
20 "racketeering activity" involved in the crime of "racketeering"
21 under NRS 207.400 and 207.470.

22 A "racketeering activity" is defined in NRS 207.390 and
23 requires that the person engage in at least "two crimes related to
24 racketeering . . ." NRS 207.390. A "crime related to
25 racketeering" is defined in 207.360. None of the crimes listed in
26 NRS 207.390 involve violation of the Nevada state securities laws
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1 under NRS 90.570, 90.580, 90.605 and 90.660. Because Plaintiff
2 has failed to plead a "crime related to racketeering" sufficiently
3 for pleading a violation of NRS 207.400, his claim of racketeering
4 will be dismissed.

5 6 **G. Punitive Damages**

7 Examining, first, whether Plaintiff is entitled to punitive
8 damages, we examine the statutory provisions under which Plaintiff
9 has sued.

10 First, punitive damages are not allowed under a private claim
11 for violation of Securities Law 10b-5. See Stone v. Kirk, 8 F.3d
12 1079, 1093 (6th Cir. 1993) ("punitive damages are not authorized in
13 private actions under § 10(b) and Rule 10b-5.") (quoting Green v.
14 Wolf Corp., 406 F.2d 291, 303 (2d Cir. 1968) cert. denied, 395
15 U.S. 977, 89 S.Ct. 2131, 23 L.Ed. 2d 766 (1969)).

16 Punitive damages are also not available for a violation of
17 Section 12(a)(2), 15 U.S.C. § 77L(a)(2), as recovery is limited by
18 15 U.S.C. § 78bb. As section 78bb specifies: "...no person
19 permitted to maintain a suit for damages under the provisions of
20 this title shall recover, through satisfaction of judgment in one
21 or more actions, a total amount in excess of his actual damages on
22 account of the act complained of." 15 U.S.C. § 78bb.

23 We note that the civil damages available under NRS 90.660 are
24 also quite limited and do not include punitive damages.

25 Since we have dismissed all of Plaintiff's tort claims, the
26 last basis, in tort for punitive damages, is the breach of implied
27 covenant of good faith and fair dealing.

1 Under Nevada law, "every contract imposes upon the
2 contracting parties, the duty of good faith and fair dealing."
3 State v. Sutton, 103 P.3d 8, 20 (2004) (quoting Hilton Hotels v.
4 Butch Lewis Productions, 109 Nev. 1043, 1046, 862 P.2d 1207, 1209
5 (1993)). However, the recovery for this action is usually limited
6 in contractual damages except when there is a special relationship
7 between the person who breached the implied covenant and the
8 victim of such breach. Such tort damages for breach of implied
9 covenant are available when "the party in the superior or
10 entrusted position has engaged in grievous and perfidious
11 misconduct." Id. (quoting Great American Ins. v. General
12 Builders, 113 Nev. 346, 355, 934 P.2d 257, 263 (1997) (quoting K-
13 Mart Corp. v. Ponsock, 103 Nev. 39, 732 P.2d 1364 (1987))).

14 In Ponsock, the Nevada Supreme Court held that "the use of
15 punitive damages in appropriate cases of breach of the duty of
16 good faith and fair dealing expresses society's disapproval of
17 exploitation by a superior power and creates a strong incentive
18 for employers to conform to clearly defined legal duties. Such
19 duties are so explicit and so subject of common understanding as
20 to justify the punitive award." Ponsock, 103 Nev. at 53. In
21 Ponsock, a "bad faith discharge" was held to have been a tortious
22 breach of implied covenant of good faith and fair dealing. Id. at
23 54. Here, Plaintiff has demonstrated a special reliance that
24 he had on Innotrac in the exercising of his options that would
25 survive a motion to dismiss. He has plead that Defendants were in
26 a superior position due to their relative knowledge of securities
27 and the fact that they had significant bargaining power as his
28

1 employer. Because of this special element of reliance, Plaintiff
2 may be entitled to damages based on tortious breach of implied
3 covenant. Because this is a claim based on a tort, punitive
4 damages might be allowed and therefore Defendants' motion to
5 dismiss the claim for punitive damages will be denied.

6 **IT IS HEREBY ORDERED** that Defendants' motion to dismiss (#14)
7 is granted with respect to claims for fraud or intentional
8 misrepresentation (Third Claim for Relief), negligent
9 misrepresentation (Fourth Claim for Relief), breach of duty of
10 care (Fifth Claim for Relief), intentional omissions or failure to
11 disclose (Sixth Claim for Relief), general negligence (Eighth
12 Claim for Relief) and RICO claims (Twelfth Claim for Relief) with
13 leave for Plaintiff to amend.

14 **IT IS HEREBY FURTHER ORDERED** that Defendants' motion to
15 dismiss (#14) is granted with respect to the claim of breach of
16 fiduciary duty (Seventh Claim for Relief) without leave for
17 Plaintiff to amend.

18 **IT IS HEREBY FURTHER ORDERED** that Defendants' motion to
19 dismiss (#14) is denied with respect to the claims of federal
20 securities violation (Ninth Claim for Relief), Nevada securities
21 violation (Eleventh Claim for Relief), violation of section 10b-5
22 (Tenth Claim for Relief) and punitive damages (Thirteenth Claim
23 for Relief).

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This 22nd day of December, 2005.

Edward C. Reed.
UNITED STATES DISTRICT JUDGE